IN THE SUPREME COURT OF MISSOURI

No. SC93711

DILLARD'S, INC.

Respondent,

v.

DIRECTOR OF REVENUE,

Appellant.

Appeal from the Administrative Hearing Commission of Missouri
The Honorable Sreenivasa Rao Dandamudi, Commissioner

BRIEF OF RESPONDENT

Charles W. Hatfield, No. 40363
Khristine A. Heisinger, No. 42584
STINSON LEONARD STREET LLP
230 West McCarty Street
Jefferson City, MO 65101
Tel.: (573) 636-6263
Fax: (573) 636-6231
chuck.hatfield@stinsonleonard.com
khristine.heisinger@stinsonleonard.com

Brian R. Harris (*pro hac vice*)
AKERMAN LLP
401 E. Jackson St., Suite 1700
Tampa, FL 33602
Tel.: (813) 209-5011
Fax: (813) 218-5454
brian.harris@akerman.com

ATTORNEYS FOR RESPONDENT

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page(s)

CASES

STATUTES

OTHER AUTHORITIES

STATEMENT OF FACTS

Respondent is dissatisfied with the accuracy and completeness of Appellant's statement of facts, and therefore provides this statement of facts pursuant to Rule 84.04(f).

A. The Dillard's Private Label Credit Card Program

Dillard's is engaged in the business of selling tangible personal property at retail and was registered with the Missouri Department of Revenue (the "Department"). (LF 9.)[1] Dillard's remitted sales tax to the Department based on the purchase price of taxable merchandise, including credit sales. (LF 10.) In order to make additional sales and to make financing available to its customers, Dillard's offered financing through a private label credit card program. A private label credit card is a credit card that can typically only be used at the retail store named on the card or at certain affiliates. (LF 9-10; Tr. 14:25-15:6; P.Ex. A.)

Dillard's established its private label credit card program in 1991 and initially operated it through Dillard National Bank, a wholly-owned subsidiary. (Tr. 9:6-14.) On August 7, 2004, Dillard's entered into a Private Label Credit Card Program Agreement with GE Capital Consumer Card Co. ("GE Capital"). (LF 9; Tr. 9:15-18; P.Ex. A.) Pursuant to this agreement, in November 2004 Dillard's sold its private label credit card

[1] The record on this appeal consists of the trial transcript ("Tr."), the legal file ("LF"), the Petitioner's exhibits ("P.Ex.") and Respondent's exhibits ("R.Ex.") as designated.

accounts to GE Capital, and thereafter GE Capital issued the Dillard's private label credit cards.[2] (Tr. 9:15-18; P.Ex. A.)

The private label credit card program relationship between Dillard's and GE Capital is a close, ongoing relationship that is fundamentally different than a traditional Visa or MasterCard type relationship. Initially, the parties jointly negotiated the program agreement, which was a long-term, written agreement that established and governed the operation of the Dillard's private label credit card program. The program agreement defined the relationship and responsibilities of Dillard's and GE Capital with respect to the operation of the private label credit card program. (Tr. 11:10-20; P.Ex. A.)

The agreement included numerous terms that are not found in a traditional Visa or MasterCard arrangement. For example, Dillard's and GE Capital negotiated a predetermined approval rate for private label credit card applications, which GE Capital was required to maintain throughout the operation of the program. (Tr. 11:10-23.) This approval rate ensured that GE Capital extended a certain amount of credit to Dillard's customers, and as a result GE Capital had to periodically adjust its credit approval criteria

[2] Dillard's was motivated to enter into the Program Agreement with GE Capital for various business reasons, including a desire to increase its liquidity and to concentrate its focus on running its retail operations rather than on also running a credit card bank. (Tr. 9:19-25). Dillard's was also motivated by the regulations governing credit card banks and believed that GE Capital, who handled many private label credit card programs for other companies, was more adept at navigating those regulations. (Tr. 10:6-13).

to maintain that negotiated approval rate. (Tr. 11:10-20.) The agreement contained other provisions that evidenced a close working relationship between Dillard's and GE Capital with respect to the program.

For example, the program agreement established a joint marketing committee, which comprised three members from each of Dillard's and GE Capital. (Tr. 13:7-13.) The Committee had monthly meetings to review the program and to direct future marketing operations. (Tr. 13:7-13.) The decisions of the marketing committee, including any changes to the program's financial terms, had to be unanimous. (Tr. 13:7-19.) The program agreement also permitted Dillard's to set minimum service standards, which GE Capital was obligated to meet. (Tr. 21:7-21.) These minimum service standards covered servicing customers' accounts, terms of the accounts, collections and other operational aspects. (Tr. 21:7-21.)

Moreover, Dillard's opened its headquarters and stores to GE Capital's employees to facilitate the close coordination between the parties in operating the program. As Edward Williams, an employee of General Electric Retail Bank and the Senior Finance Manager of Dillard's private label credit card portfolio, testified at the hearing, he and eight other General Electric employees worked full time at Dillard's headquarters in Little Rock, Arkansas on the program. (Tr. 41:10-12.) Mr. Williams testified that he even shared an office wall with Randall Hankins, Dillard's Vice President with primary responsibility for managing the relationship between Dillard's and GE Capital and its other witness in this case. (Tr. 8:8-14, 41:10-12.) GE Capital also had another six

employees that worked full time throughout the nation at various Dillard's stores to support the private label credit card program. (Tr. 43:4-8.)

When a customer made a purchase at a Dillard's store with a Dillard's private label credit card, the customer financed the purchase price and associated sales tax on the customer's private label credit card. (LF 9; Tr. 17:18-25.) GE Capital reimbursed Dillard's on a daily basis for amounts charged to the private label credit cards. (LF 10; Tr. 17:18-25.) This reimbursement was adjusted to take into account returns, charge-backs and other financial obligations between Dillard's and GE Capital. (LF 10; Tr. 17:18-25, 29:4-21, 30:23-31:15, 31:16-20.) Dillard's then filed the appropriate sales tax returns and remitted the sales tax that was due on these transactions to the state. (LF 10-11; Tr. 18:1-3, 31:16-24; R.Ex. 1.) After customers had made charges on their cards, Dillard's provided the service of allowing customers to make payments on their account balances at Dillard's stores. (Tr. 30:6-21.) These in-store payments were then an obligation that Dillard's owed to GE Capital under the terms of the agreement. (Tr. 30:6-21.)

Thus, although GE Capital issued the private label credit cards, Dillard's was not merely a passive observer to the program. Both Dillard's and GE Capital's daily participation was integral to the program's operation, and both devoted significant time and resources to its operation. Also, as described in Subsection B, *infra*, Dillard's had an ongoing financial interest in the program that was directly affected by the program's income and losses.

B. Dillard's and GE Capital Shared Private Label Credit Card Program's Income and Expenses, Including Bad Debts

One significant aspect of the private label credit card program agreement was that Dillard's and GE Capital agreed to share the program's income and losses. As Mr. Williams, the Senior Finance Manager at GE Capital testified, the program was "viewed as a …joint economic deal." (Tr. 43:13-17.) Dillard's and GE Capital shared any income generated by the private label credit card accounts, including various finance charges, late fees and other income. (Tr. 17:1-11; P.Ex. A; R.Ex. 2.) The parties also shared losses associated with the private label credit card program, including the bad debt losses that are the basis of Dillard's refund claim. (Tr. 19:22-20:5; P.Ex. A; R.Ex. 1.) This sharing was settled on a monthly basis through payments from GE Capital to Dillard's. (P.Ex. A.)

Although GE Capital initially reimbursed Dillard's for the purchase price and sales tax that customers charged to their private label credit cards, that was not the end of the transaction. (Tr. 16:19-17:15; P.Ex. A.) If the customers subsequently defaulted on their private label credit cards, the bad debt losses were deducted from the program's income, which directly reduced the amount of the monthly profit sharing payments that GE Capital made to Dillard's throughout the program. (P.Ex. A.) In fact, Mr. Williams described that "when an account is charged off [by GE Capital] and there is a loss," that Dillard's had a "financial loss as a result of that [write-off]." (Tr. 40:9-40:15.)

C. Dillard's Refund Claim

During the operation of the Dillard's private label credit card program, various cardholders defaulted on their payment obligations. (Tr. 43:18-44:3.) After attempts to collect these past due amounts, which included sales tax attributable to the amount of the unpaid taxable charges, GE Capital found them to be worthless and uncollectible. (Tr. 43:18-44:3.) It charged them off for accounting purposes and deducted them as bad debts on its federal corporate income tax returns. (Tr. 44:16-22; R.Ex. 1.) Pursuant to the private label credit card program agreement, GE Capital deducted these losses from the program's income, thus reducing Dillard's share of the program's income. (Tr. 43:18-44:3; R.Ex. 2.)

On December 23, 2010, Dillard's filed a refund claim with the Department for a sales tax refund of $206,543, which was attributable to private label credit card accounts having purchases in Missouri that became worthless over the period of January 1, 2009 to June 30, 2010. (LF 1-5, 11; Tr. 5:13-21.)

INTRODUCTION/SUMMARY OF ARGUMENT

Dillard's, like many retailers, provided financing to its customers through a private label credit card program. Dillard's initially operated the program itself but, in 2004, formed an alliance with GE Capital. Pursuant to the terms of the program, GE Capital issued private label credit cards to Dillard's customers, which they used to finance purchases at Dillard's stores. As required by Missouri law, Dillard's prepaid the sales tax on these purchases to the state. Contemporaneously with the purchases, GE Capital reimbursed Dillard's for the amounts charged to the private label credit cards.

These contemporaneous reimbursements, however, did not close the transactions from either Dillard's or GE Capital's perspective. Dillard's and GE Capital had agreed to share the program's income and losses. When customers defaulted on their private label credit cards, GE Capital deducted these bad debts from the program's income, and this directly reduced the amount of the monthly profit sharing payments that GE Capital made to Dillard's. While the factual record regarding this income and loss sharing is undisputed, the Director fails to even acknowledge this arrangement in his opening brief. And if this omission was not enough, the Director doubles down and accuses Dillard's of trying "to obtain a refund of an amount that the retailer itself did not lose." Not only does the Director urge this Court to overturn the Commission's decision based on a distortion of the factual record below, but by his own admission his position has no support in the plain language of the regulation either.

Missouri law entitles sellers to seek refunds of these bad debts. Specifically, Section 144.190, RSMo, grants sellers the right to seek refunds of overpaid taxes, and a corresponding regulation, 12 CSR 10-102.100, specifically addresses credits and refunds resulting from bad debts. The regulation imposes two requirements in order for a seller to obtain a sales tax refund: (1) the sales must have been written off as bad debts; and (2) the sales must have been previously reported as taxable. Dillard's claim meets these two requirements, and therefore it is entitled to a sales tax refund as a matter of law.

The Director opposes Dillard's refund claim on the principal basis that GE Capital, and not Dillard's, wrote off the program's bad debts. The Director admits in his brief, however, that his own regulation does not require that Dillard's be the entity that wrote

off the bad debts. (Director's Br. 10.) Instead, the Director urges this Court to judicially revise his regulation to impose that requirement. However, this Court has made clear that it "must enforce statutes as written, not as they might have been written," and that "[t]his Court cannot add language to the statute that the legislature did not include." *City of Wellston v. SBC Commc'ns, Inc.*, 203 S.W.3d 189, 193 (Mo. banc 2006). Moreover, "[t]he same rules of construction are used to interpret regulations as are used to interpret statutes." *State ex rel. Evans v. Brown Builders Elec. Co., Inc.*, 254 S.W.3d 31, 35 (Mo. banc 2008). Thus, even if this Court were to look past the plain language of the Director's regulation, it must still uphold the Commission's decision.

For example, this Court has also stated that while tax exemption statutes are "strictly but reasonably (so as not to curtail the intended scope of the exemption) construed," those provisions "are to be given a reasonable, natural, and practical interpretation in the light of modern conditions in order to effectuate the purpose for which the exemption is granted." *St. John's Mercy Hosp. v. Leachman*, 552 S.W.2d 723, 725 (Mo. banc 1977); *Barnes Hosp. v. Leggett*, 589 S.W.2d 241, 244 (Mo. banc 1979); *Barnes Hosp. v. Leggett*, 646 S.W.2d 889, 893 (Mo. App. 1983). In this case, Dillard's refund is in accord with the very purpose behind the regulation.

Collecting sales tax on the purchase price that is actually paid is the foundation of Missouri's sales tax system, and providing sales tax refunds to sellers following credit defaults advances this principle. The statute and regulation therefore serve a clear purpose: to ensure that the state collects sales tax on the price that the purchaser actually paid and, at the same time, to ensure that a retailer who is required to prepay sales tax on

credit purchases is not penalized if the purchaser subsequently defaults. How the purchase was financed – whether by the seller directly or through an alliance with GE Capital – in no way evokes or concerns the purpose underlying the Director's regulation.

The economic reality of the current marketplace is that retailers rarely provide direct financing to consumers anymore. Regardless of the reason for this change, whether because of the complex web of state and federal banking and other regulations that govern the issuance of credit cards or some other reason, the vast majority of retailers now extend credit through a private label credit card program that is established through an alliance with a finance company like GE Capital. The sales tax overpayments and bad debt losses are no less real, however, simply because they occur through the course of the retailers' private label credit card programs. The Director's interpretation would exempt the vast majority of retailer-based financing from the scope of his regulation, thereby frustrating the very purpose behind it.

The Director readily admits that the plain language of his regulation does not restrict who must have written off the bad debts and therefore that it authorizes Dillard's refund claim. No principle of interpretation supports deviating from the plain language of the regulation. This Court has said on numerous occasions that it will apply statutes and regulations as they are written and not as they *might* have been written. And even if the Court were to look past the plain language of the regulation, the Commission's decision still effectuates the underlying purpose of the regulation and reaches a sensible result. Nevertheless, the Court must apply the plain language of the regulation, and it

should therefore uphold the Commission's decision and find that Dillard's is entitled to a sales tax refund as a matter of law.

ARGUMENT

I. Standard of Review

This Court must affirm the Administrative Hearing Commission's decision if it "is authorized by law and supported by competent and substantial evidence upon the record as a whole unless clearly contrary to the reasonable expectations of the General Assembly." *Featherston v. Director of Revenue*, 412 S.W.3d 221, 222 (Mo. banc 2013) (quoting *Street v. Director of Revenue*, 361 S.W.3d 355, 357 (Mo. banc 2012)).

This Court reviews the Administrative Hearing Commission's interpretation of revenue laws *de novo*. *Featherston*, 412 S.W.3d at 222. The Commission's findings of fact will be upheld if the findings are supported by substantial evidence on the whole record. *Id.*

II. Missouri's Statutes and Regulation Provide for Sales Tax Refunds Attributable to Bad Debts

Missouri law imposes a tax "upon all sellers for the privilege of engaging in the business of selling tangible personal property or rendering taxable service at retail in this state." Section 144.020, RSMo. The sellers are required to file sales tax returns and remit the sales tax. 12 CSR 10-104.030. Moreover, Missouri law requires that sellers pay the full sales tax upfront to the state even on credit transactions where there is no assurance that the customer will pay all, or even any, of the purchase price and sales tax that was financed on the customer's private label credit card. 12 CSR 10-103.555. If the

purchasers subsequently default, then the state has collected sales tax on a purchase amount that was never actually paid.

A. The Director's Regulation Expressly Authorizes Refunds of Sales Taxes that were Overpaid as a Result of Credit Card Bad Debts

The Legislature and the Director both recognize this inequity, and they have jointly provided a statutory and regulatory remedy. Section 144.190, RSMo permits sellers to claim refunds of sales taxes that are "erroneously or illegally collected." This Court has previously held that section 144.190 is a waiver of the state's sovereign immunity and that it provides a mechanism by which taxpayers can reclaim taxes that were erroneously or illegally collected. *Charles v. Spradling*, 524 S.W.2d 820, 823 (Mo. banc 1975).

The Director agrees in his brief that sales taxes paid to the state at the time of purchase on financed transactions are "erroneously" paid as a result of subsequent bad debts and therefore subject to refund. (Director's Br. 9.) Indeed, the Director has promulgated a regulation that specifically authorizes the refund of sales taxes attributable to bad debts. 12 CSR 10-102.100. The Director's regulation provides, in part, that:

> (1) In general, a seller may file for a credit or refund within the three-year statute of limitations when sales are written off as bad debts.
>
> (2) Definition of Terms.
>
> (A) Bad debt is a sale that has been written off for state or federal income tax purposes. In order to qualify for a bad debt deduction for sales or use tax purposes, a sale must have been previously reported as taxable.

(B) Accrual or gross sales reporting method means a seller reports the sale and remits the tax at the time of the sale. The receipts are not received from the buyer until a later date. Therefore, a timing difference occurs between the time that the sale, with applicable sales tax, is reported to the state and the time that the seller receives payment from the buyer.

(3) Basic Application of the Law.

(A) A seller may file for a refund or credit within the three-year statute of limitations for those sales written off as bad debts if the sales were reported using the accrual or gross sales method. This period is calculated from the due date of the return or the date the tax was paid, whichever is later.

(B) If a bad debt credit or refund is given and the debt is later collected, that amount must be reported on the next return as a taxable sale.

12 CSR 10-102.100.

B. Dillard's Meets the Requirement of the Director's Regulation, Which Does Not Require that any Particular Entity Have Written Off the Bad Debt

The Director acknowledges in his brief, as he must, that his regulation does not require that Dillard's be the entity that wrote off the bad debts. (Director's Br. 11.) As the Director describes, the regulation "does not expressly restrict 'bad debt' to debt written off by Dillard's as the seller." (Director's Br. 11.) The regulation provides that "a seller may file a credit or refund within the three-year statute of limitations when sales

are written off as bad debts." 12 CSR 10-102.100(1). It also defines "bad debt" as "a sale that has been written off for state or federal income tax purposes." 12 CSR 10-102.100(2)(A).

Nowhere in the language of the regulation, however, is any requirement that the seller must have written off the bad debt. This is not surprising because the requirement that the bad debt have been written off was never meant to impose a substantive requirement that a particular entity must have written off the bad debts. Rather, the bad debt write-off provision was intended to dictate the timing of the retailer's sales tax refund or credit. That is, a retailer was not entitled to immediately obtain a refund or credit at the first moment the customer did not pay the financed amounts. Instead, the retailer had to wait until the charges were written off for income tax purposes.

Under the plain language of the regulation, Dillard's is entitled to a refund if Dillard's previously reported the sales as taxable and if the sales were written off as bad debts. 12 CSR 10-102.100. And there is no factual dispute that Dillard's claim meets these two requirements. Because the language of the regulation is clear, there was nothing more for the Commission to do than simply apply the language of the regulation to the facts of this case. *See Hyde Park Hous. P'ship v. Director of Revenue*, 850 S.W.2d 82, 84 (Mo. banc 1993) ("The primary rule of statutory construction is to ascertain the intent of the lawmakers by construing words used in the statute in their plain and ordinary meaning."); *Bateman v. Rinehart*, 391 S.W.3d 441, 446 (Mo. banc 2013) ("When the words are clear, there is nothing to construe beyond applying the plain meaning of the law.") (internal quotations omitted); *State ex rel. Evans*, 254 S.W.3d at 35 ("The same

rules of construction are used to interpret regulations as are used to interpret statutes.”). Indeed, no further interpretation or analysis of the regulation is even permissible.

Nevertheless, after recognizing that its regulation does not specify who must have written off the bad debts, the Director attempts to manufacture issues of statutory interpretation where no such issues exist. First, the Director attempts to frame the issue of this case as one regarding the extent to which the State has waived its sovereign immunity. (Director's Br. 12.) As the Director describes, "the entitlement to a refund is a waiver of sovereign immunity" and the "question of who can obtain a refund is purely one of the statute that waives immunity." (Director's Br. 12.)

This purported issue is of no moment. Missouri's refund statute allows sellers to claim refunds of taxes that are "erroneously" collected. Section 144.190, RSMo. This refund statute is an express waiver of the state's sovereign immunity, thereby permitting Dillard's to seek a refund of any taxes that were erroneously collected. *See Charles*, 524 S.W.2d at 823 (finding that Section 144.190, RSMo is a waiver of the government sovereign immunity). There is absolutely no dispute that the State has waived its sovereign immunity and that Dillard's has a statutory right to seek a sales tax refund.

The Director defined the parameters of these erroneously collected taxes in his regulation, and in doing so he has not required that Dillard's be the entity that has written off the bad debts. 12 CSR 10-102.100. He has only required that the seller have previously reported the sale as taxable. *Id*. On this point, the Director attempts to have the Court eschew the plain language of the regulation and instead have this Court insert a judicially imposed requirement that Dillard's have been the entity that wrote off the bad

debts. However, Missouri law does not permit judicial modification of a valid statute or regulation.

As this Court has previously explained, it is not its role to pass judgment on which legislative schemes might have been the best or most logical choices. *City of Wellston*, 203 S.W.3d at 192; *see also Turner v. School Dist. of Clayton*, 318 S.W.3d 660, 668 (Mo. banc 2010) ("Moreover, it is not within the Court's province to question the wisdom, social desirability, or economic policy underlying a statute as these are matters for the legislature's determination.") (internal quotations omitted).

Rather, "[t]his Court must enforce statutes as written, not as they might have been written." *City of Wellston*, 203 S.W.3d at 192. "This Court cannot add language to the statute that the legislature did not include." *Id*; see *also Turner*, 318 S.W.3d at 668 ("Accordingly, the Court cannot supply what the legislature has omitted from controlling statutes."). As this Court so eloquently described: "The courts cannot transcend the limits of their constitutional powers and engage in judicial legislation supplying omissions and remedying defects in matters delegated to a coordinate branch of our tripartite government." *Board of Educ. of the City of St. Louis v. State*, 47 S.W.3d 366, 371 (Mo. banc 2001). Such canons must apply with equal force to the state's regulations. *State ex rel. Evans*, 254 S.W.3d at 35. Therefore, this Court must reject the Director's attempts to judicially insert a requirement that Dillard's be the entity that wrote off the bad debts.

C. Missouri Law Views the Combination of GE Capital and Dillard's as a Single "Seller" and Whether Dillard's Incurred Bad Debts Itself is Legally Irrelevant

In addition to the above, the Commission's decision is additionally correct when the language of the regulation is read together with the applicable statutory definitions. Under Missouri law, a "seller" is defined as "a person selling or furnishing tangible personal property or rendering services, on the receipts from which a tax is imposed pursuant to section 144.020." Section 144.010(12), RSMo (emphasis added). Missouri law in turn defines "person" as:

> (7) "Person" includes any individual, firm, copartnership, joint venture, association, corporation, municipal or private, and whether organized for profit or not, state, county, political subdivision, state department, commission, board, bureau or agency, except the state transportation department, estate, trust, business trust, receiver or trustee appointed by the state or federal court, syndicate or any other group or combination acting as a unit, and the plural as well as the singular number."

Section 144.010(7), RSMo (emphasis added).

Thus, the statutory definition of "seller" is not limited to a single entity, such as only Dillard's, but also includes any "group or combination acting as a unit." That is, it includes the combination of Dillard's and GE Capital. Therefore, if Dillard's did not arguably qualify for a refund in its own right pursuant to 12 CSR 10-102.100, then it

certainly does when the regulation is read in conjunction with the statutory definition of "seller," which views Dillard's and GE Capital as a single "seller."

The Director's regulation likewise uses the term "seller." It begins by providing that "a seller may file for a credit or refund within the three-year statute of limitations when sales are written off as bad debts," and it continues to use that term throughout the regulation. 12 CSR 10-102.100(1). The Director does not separately define "seller" in its regulation. Indeed, the subsection titled "(2) Definition of Terms" only defines "bad debt" and "accrual or gross sales reporting method." 12 CSR 10-102.100(2).

By porting the term "seller" into his regulation, the Director brought along with that term its statutory definition. Indeed, it would make little sense for the Director to define "seller" in the regulation when that term is already defined in the statutes. And although within his power to do so, it would make even less sense for the Director to define the term "seller" differently in regulation than in the statute. Regardless, it is clear that the Director made no attempt to alter the statutory definition of seller. It has exactly the same meaning in the regulation as it has in the statute, and under the statute it is defined to include a "group or combination acting as a unit."

There is no doubt that the regulation permits a refund where Dillard's makes the sales and where GE Capital writes off the bad debts. The Director admits in his brief that the regulation does not dictate who must have written off the bad debt. However, even if the Court were to judicially rewrite the regulation in the manner advocated by the Director to require that the "seller" have written off the bad debt, the Commission's

decision is still correct because Dillard's and GE Capital collectively constitute the "seller" that is entitled to the bad debt refund.

That is, even assuming *arguendo* that the Department's regulation did require that the "seller" have written off the bad debts, that still does not require that Dillard's have written off the bad debts. The term "seller," as used in the regulation, means the combination of Dillard's and GE Capital. Even with GE Capital writing off the bad debts, the collective "seller" has still fulfilled both requirements of the regulation and thus Dillard's is entitled to the sales tax refund.

The Commission's decision correctly applies these statutory definitions. First, the Commission correctly recognized that "Dillard's is a corporation that fits the definition of person when acting alone." (LF 33.) Because of this statutory definition, the Commission also correctly held that "Dillard's and the Bank, acting as a unit, fit the definition of 'person'" and that "there is no dispute that Dillard's and the Bank, acting as a unit, was a person that fits the definition of 'seller.'" (LF 39.)

As such, the Commission's ultimate conclusion, that Dillard's is entitled to its refund, is also correct:

> …As a seller, Dillard's and the Bank, acting as a unit, qualify for a sales tax refund under 12 CSR 10-102.100(3)(A), if they meet the two requirements of this regulation: that it reported and remitted sales tax at the time of the sale and the sales were written off as bad debts.

> Dillard's reported and remitted sales tax at the time of the sale. The Bank wrote off some of these sales as bad debts. Both Dillard's and the Bank, acting as a unit, are a person. As such, they are a seller that is entitled to a sales tax refund on overpaid sales taxes under 12 CSR 10-102-100(3)(A).

(LF 39.)

Therefore, even with the judicial revisions that the Director advocates, the Commission's decision is still consistent with the statutory scheme established by the Missouri Legislature and Dillard's would still be entitled to a refund.[3]

[3] The Director cites *Central Cooling & Supply Co. v. Director*, 648 S.W.2d 546 (Mo.1983) and alleges that it precludes Dillard's and GE Capital from being viewed as a single taxpayer unit pursuant to the statutory definition of "person." While the facts are not well developed in the opinion, it appears that Central Cooling paid sales taxes to Kansas on out of state purchases and faced sales tax a second time on an intercompany sale of the items to its parent corporation. *Id*. at 549. Central Cooling attempted to use the statutory definition to escape any taxation whatsoever on an otherwise taxable transfer. In contrast, Dillard's fully paid the sales taxes that were due and is simply trying to obtain the protection of the Department's bad debt regulation. Given the significant factual differences, *Central Cooling* seems to have little application in this case.

III. Even if the Court Looked Past the Plain Language of the Regulation, Other Principles of Statutory Interpretation Still Require that the Director Refund the Taxes that Dillard's Overpaid

The Commission's decision granting Dillard's refund claim not only correctly interprets the Director's regulation, but it also reaches a reasonable and equitable result. This is especially so given that Dillard's and GE Capital agreed to share in the program's income and losses and that the program's bad debts reduced Dillard's share of the income – something that the Director refuses to even acknowledge in his opening brief. Therefore, if the Court were inclined to look past the plain language of the Director's regulation, the Commission's ruling is still in accord with other basic principles of statutory interpretation that might then apply.

The starting, and often ending, point of statutory and regulatory interpretation is the plain language of the statute. This Court has directed that it "will look beyond the plain meaning of the statute only when the language is ambiguous or would lead to an absurd or illogical result." *Bateman*, 391 S.W.3d at 446. Dillard's seeks a refund of sales taxes that it previously paid to the State. As described in Facts, Section (B), *supra*, Dillard's directly shared in the program's losses. Granting Dillard's refund claim in such a circumstance can hardly be termed "absurd or illogical," and therefore there is no reason to look past the plain language of the regulation.

However, if one were to examine other factors that might bear on the interpretation of the Director's regulation, the Court has previously directed that while the general rule is that tax exemptions, "though not subject to extension by construction or

implication, are to be given a reasonable, natural, and practical interpretation in the light of modern conditions in order to effectuate the purpose for which the exemption is granted." *Barnes Hosp.*, 589 S.W.2d at 244; *Barnes Hosp.*, 646 S.W.2d at 893 (emphasis added). This Court has also directed that "[w]hen determining the merits of revenue cases, it is important to look beyond legal fictions and academic jurisprudence in order to discover the economic realities of the case." *Scotchman's Coin Shop, Inc. v. Administrative Hearing Comm'n*, 654 S.W.2d 873, 875 (Mo. banc 1983). Deciding whether an exemption applies to a taxpayer also depends on the specific circumstances and economic realities pursuant to which the exemption is claimed. *Barnes Hosp.*, 646 S.W.2d at 893 ("[E]ach tax exemption case is peculiarly one which must be decided upon its own facts, turning upon the particular records presented.").

Here, it is easy to discern the purpose of the Department's regulation. For cash transactions, sales tax is computed based on the amount that the purchaser actually pays for the merchandise. The state does not set the sales price of merchandise; it simply collects sales tax based on whatever price is actually paid by the purchaser. This is the underlying principle of Missouri's sales tax system and that of most other states too. On credit transactions, Missouri law requires that retailers prepay sales tax. However, there is no guarantee that the purchaser will ultimately pay the financed purchased price. When a purchaser subsequently defaults without paying the full amount of the purchase price, the result is that the state has collected sales tax on an amount that was more than what the purchaser actually paid.

The Director's regulation reforms this transaction to be consistent with the underlying principle of the state's sales tax system – that the state only collect sales tax on the purchase price that is actually paid. Conversely, interpreting 12 CSR 10-102.100 to deny Dillard's a sales tax refund would be at odds with the purpose of the regulation and would result in the state keeping sales taxes computed on amounts that the purchasers never ultimately paid. That is the antithesis of the entire basis of Missouri's sales tax system. The regulation was designed to further the principle of permitting the state to only collect sales tax on the price actually paid, and permitting Dillard's to obtain a refund furthers that purpose.

Allowing Dillard's to obtain a refund also recognizes the economic reality that retailers have largely moved away from offering financing directly, and instead they largely make financing available to their customers through private label credit card programs. There is no dispute that Dillard's would be entitled to a refund under 12 CSR 10-102.100 if it had financed the transactions itself. Indeed, Dillard's initially operated its own private label credit card program and it did so through Dillard National Bank, a wholly owned subsidiary and separate legal entity.

During the time that Dillard's operated its own private label credit card program, it claimed these bad debt deductions and was entitled to receive them. However, a growing web of complex federal regulations and other consideration pushed Dillard to adopt the same course as so many others in the industry – to operate its private label credit card program through an alliance with GE Capital. Now, instead of running the private label

credit card program through a separate subsidiary, it has shifted that component of the program to GE Capital.

Dillard's should be no less entitled to a refund simply because it operated its private label credit card program through an alliance with GE Capital rather than by itself. The nature of the financing does nothing to alter the state's interest in only collecting sales tax on the price actually paid. There is simply no compelling reason to treat purchases financed directly by the retailer differently than purchases financed through private label credit card programs. This is particularly true where, as in this case, the private label credit card program is structured to shift a portion of the program's bad debt losses to Dillard's share of the program's income.[4]

Indeed, one of the most striking aspects of the Director's brief is its failure to acknowledge that GE Capital and Dillard's share the program's income and losses and the bad debt losses are deducted from the program's income, thereby reducing Dillard's income from the program. That is, notwithstanding whatever reimbursements Dillard's might have received from GE Capital contemporaneously with the financed purchases,

[4] The close knit nature of the private label credit card programs, including this type of income and loss sharing, differentiates them from the traditional Visa and MasterCard type relationship that does not possess those same qualities. Thus, the Commission's decision in this case does not necessitate or even imply that such claims would be permissible for ordinary credit card bad debts. The decision is confined to private label credit card debt, and correctly so.

Dillard's directly shouldered a significant portion of the program's bad debt losses when those bad debt losses ultimately occurred.

In its brief, the Department describes the private label credit card transactions and reimbursements without any mention of the parties' sharing of income and losses:

> Each time a customer made a purchase from Dillard's using the Dillard's Card, three things happen: the customer receives the merchandise; GE Capital pays Dillard's the purchase price and applicable sales tax, and Dillard's remits to the Director of Revenue the sales tax due on the sale. *Id*. During the period at issue, after those three things had happened, some Dillard's Card holders defaulted on their payment obligations to GE Capital. *Id*. And when GE Capital found it was unable to collect on past due accounts, it wrote them off as bad debts and deducted those bad debts from federal income tax otherwise owned [sic] by GE Capital. *Id*.

(Director's Br. 2-3.)

Later in his brief, the Director poses the question presented by this case as: "whether the statute allows a retailer to obtain a "bad debt" refund even when the retailer itself successfully completed a sale – i.e., the retailer was paid for the goods and the associated tax, the customer took the goods, and the retailer remitted the tax paid to it on the transaction." (Director's Br. 11.) As if this were not enough, the Director also affirmatively asserts that Dillard's is trying "to obtain a refund of an amount that the

retailer itself did not lose."[5] (Director's Br. 6.) Nowhere in his brief is any acknowledgment of what are undisputed facts – that the parties shared the program's income and losses, and that a portion of the subsequent bad debt losses were indeed deducted from Dillard's share of income.[6] *See* Statement of Facts, Section B, *supra*.

---

[5] The Director's phrasing of the issue reveals that he is attempting to impose two additional requirements that are not found in the regulation. First, and as previously discussed, he is attempting to require that Dillard's have written off the bad debts. Second, he asserts that Dillard's had to incur a loss, apparently meaning that Dillard's had to directly record the bad debts on its books. Not only is such a requirement not in the regulation, but it ignores the myriad of ways in which the retailer could bear some or all of the program's bad debt losses, such as by indirectly building the losses into the pricing and other financial terms of the program agreement. In this case, it also ignores the facts – which establish that a portion of the bad debt losses were deducted from Dillard's share of the program's income.

[6] Indeed, it appears that Dillard's may even be entitled to claim a deduction for its portion of the bad debts on its federal income tax returns pursuant to 26 U.S.C. § 166. Federal law provides that any payments made on "a debt obligation" by an entity acting as a "guarantor, endorser or indemnitor of (or other secondary obligor upon)" are entitled to be deducted under IRC § 166. 26 C.F.R. § 1.166-9(a). *Horne v. Commissioner*, 523 F.2d 1363, 1365 (9th Cir. 1975) ("The loss covered by section 166(d) … includes not only any loss sustained by the obligee of the debt but also any loss sustained by a third party,

The end result of the Director's interpretation would be to exempt the vast majority of retailer-based financing from the scope of 12 CSR 10-102.100, thereby rendering the protection of the regulation wholly illusory to most retailers. Such an interpretation is not only manifestly unjust but it is also contrary to the law. It ignores the economic reality that most retailers now operate their programs through an alliance with a financing company. It also ignores the economics of this program, which is that Dillard's shares in the program's income and losses, including bad debts. The Commission's decision, however, is not only consistent with the plain language of the Department's regulation but also recognizes the economic realities of the modern retail industry and the specific program agreement that Dillard's has with GE Capital.

IV. While the Cases Cited by the Commission From Other States Might be Instructive, Dillard's Claim Will Be Decided Under Missouri Law

In its decision, the Commission undertook a detailed review of numerous cases across the country addressing tax refund claims by lenders and retailers for sales tax refunds attributable to bad debts on private label credit cards or other financed transactions. The Commission found that most of these cases were not relevant – either because they involved claims brought by the lenders (instead of the retailers) or because the states' statutes and regulations were not similar enough to Missouri law to provide

---

whether acting as surety, guarantor, or indemnitor. Thus, the section is triggered by the worthlessness of the principal debt, and no independent debt between principal debtor and the third party, created by subrogation, is necessary.").

any guidance. (LF 15-33.) The Commission found two cases, one from Arizona and one from Michigan, that it believed might provide some guidance. *Home Depot USA, Inc. v. Arizona Department of Revenue*, 287 P.3d 97 (Az. Ct. App. 2012); *Home Depot USA, Inc. v. State of Michigan et al*, 2012 WL 1890219 (Mich. Ct. App. May 24, 2012) (UNPUBLISHED), leave to appeal denied.[7]

Between these two cases, the Commission found that the Michigan case, which upheld a retailer's right to sales tax refunds attributable to bad debts on its private label credit card program, was more persuasive. (LF 32-33.) Neither the Arizona or Michigan cases, however, considered a private label credit card program where the participants shared the programs income and losses and where a portion of the program's bad debts were deducted from a retailer's share of the program's income. (LF 29-33.) Thus, while Dillard's certainly agrees with the holding in the Michigan case, its circumstances present an even more compelling case for eligibility under Michigan or Missouri's statute.

The Director did not discuss these cases in his opening brief. It is unclear whether the Director believes that they are not applicable given the income and loss sharing in Dillard's agreement, which was not present in those cases, or whether he is simply saving any discussion for his reply brief. In any event, while these cases may be a guide, it is

[7] A subsequent panel of the Michigan Court of Appeals has since reached the opposite result, and an application for leave to appeal is currently pending with the Michigan Supreme Court. *Menard, Inc. v. Department of Treasury*, 302 Mich.App. 467, 2013 WL 4863990 (Mich. App. 2013).

clear that this case will largely be decided under Missouri law and the unique facts of Dillard's program agreement.

V. Conclusion

Both Dillard's and the Director agree that Missouri's bad debt statute and corresponding regulation do not impose any requirement that Dillard's have been the entity that wrote off the bad debts. Dillard's is therefore entitled to a refund under the plain language of the regulation, and well settled principles of statutory interpretation do not permit this Court to look past its plain language. There is simply no legal justification for the Director's position, which would have the Court engage in a judicial revision of the regulation and effectively insert additional language purporting to require that Dillard's be the entity that wrote off the bad debts.

Not only is the Commission's decision consistent with the plain language of the regulation, but it is also consistent with the statutory definition of "seller," which includes a "group or combination acting as a unit." The Director ported the term "seller" into his regulation. Thus, even if the regulation required that the "seller" write off the bad debts, that term includes the combination of Dillard's and GE Capital. That is, the regulation views Dillard's and GE Capital as a collective "seller," and Dillard's is entitled to a refund regardless of whether Dillard's or GE Capital writes off the bad debts.

Moreover, even if the Court were to look past the plain language of the regulation, granting Dillard's refund recognizes this Court's prior direction that tax statutes must be interpreted in light of modern conditions and to effectuate the purpose behind the statute. Refunding these overpaid taxes to Dillard's ensures that the state has only collected sales

tax on the purchase price that is actually paid. It also recognizes the reality that most larger retailers no longer run their own private label credit card programs.

The Director's interpretation fails to recognize the purpose behind the statute and would exempt a large number of retailers from the protection that the statute was designed to provide. Such an interpretation is not only contrary to the language of the regulation, but it is unjust. It is particularly egregious in programs such as this one where Dillard's shares in the program's income and losses and where the program's bad debt losses directly reduce Dillard's share of income – something that the Director fails to even acknowledge in his factual discussion of Dillard's private label credit card program.

Accordingly, Dillard's requests that the Court uphold the Commission's decision and find that Dillard's is entitled to a sales tax refund in the amount of $206,543, plus applicable interest.

Respectfully submitted,

/s/ Khristine A. Heisinger

Charles W. Hatfield, No. 40363
Khristine A. Heisinger, No. 42584
STINSON LEONARD STREET LLP
230 West McCarty Street
Jefferson City, MO 65101
(573) 636-6263
(573) 636-6231 (facsimile)
chuck.hatfield@stinsonleonard.com
khristine.heisinger@stinsonleonard.com

and

Brian R. Harris (*pro hac vice*)
AKERMAN LLP
401 East Jackson Street
Suite 1700
Tampa, FL 33602
(813) 223-7333
(813) 218-5454 (facsimile)
brian.harris@akerman.com

ATTORNEYS FOR DILLARD'S, INC.

CERTIFICATE OF SERVICE AND COMPLIANCE

I hereby certify that a true and correct copy of the foregoing was served electronically via Missouri Case.Net, on March 26, 2014, upon:

James R. Layton
Solicitor General
ATTORNEY GENERAL'S OFFICE
P.O. Box 899
Jefferson City, MO 65102-0899
(573) 751-1800
(573) 751-0774 (facsimile)
James.Layton@ago.mo.gov

and that a true and correct copy of the foregoing was mailed, U.S. Mail, First Class postage prepaid, to:

Administrative Hearing Commission
P.O. Box 1557
Jefferson City, MO 65102-1557

The undersigned further certifies that the foregoing brief complies with the limitations contained in Rule 84.06(b) and that the brief contains 8,244 words.

/s/ Khristine A. Heisinger
Attorney